

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF REID VILLAGE WATER)	
DISTRICT, OF MONTGOMERY COUNTY,)	
KENTUCKY, FOR (1) A CERTIFICATE OF)	
PUBLIC CONVENIENCE AND NECESSITY,)	
AUTHORIZING AND PERMITTING SAID WATER)	
DISTRICT TO CONSTRUCT A WATERWORKS)	
CONSTRUCTION PROJECT, CONSISTING OF)	
EXTENSIONS, ADDITIONS, AND IMPROVE-)	CASE NO. 9012
MENTS TO THE EXISTING WATERWORKS)	
SYSTEM OF THE DISTRICT; (2) APPROVAL)	
OF THE PROPOSED PLAN OF FINANCING OF)	
SAID PROJECT; AND (3) APPROVAL OF)	
THE INCREASED WATER RATES PROPOSED)	
TO BE CHARGED BY THE DISTRICT TO)	
CUSTOMERS OF THE DISTRICT)	

O R D E R

The Reid Village Water District ("Reid Village") filed an application on March 19, 1984, for approval of adjustments to its water service rates, authorization to construct a \$215,000 water-works improvements project, and approval of its financing for the proposed project. Reid Village's project financing includes \$44,150 in Reid Village funds, \$10,850 from applicants for service in the proposed project area, a loan of \$125,000 from the Farmers Home Administration ("FmHA") at 9 1/8 percent annual interest, and a grant of \$35,000 from the FmHA. Due to bid overruns the proposed funding for this project now includes a \$91,000 FmHA grant, making the total project cost \$271,000. Reid Village will

issue waterworks revenue bonds as security for the FmHA loans. The repayment period for the loan will be 40 years. The proposed improvements will extend service to about 31 additional customers.

Plans and specifications for these improvements as prepared by Geo-Technical Engineers, Inc., of London, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet.

The rates proposed by Reid Village would produce additional annual revenues of \$18,930, an increase of 26.7 percent over test period revenues. Based on the determination herein, the revenues of Reid Village will increase by \$11,622 annually, an increase of 16.6 percent over the adjusted test period revenues.

A hearing was held in the offices of the Public Service Commission, Frankfort, Kentucky, on July 18, 1984. There were no intervenors, and no protests were entered.

COMMENTARY

Reid Village is a non-profit water district organized and existing under the laws of the Commonwealth of Kentucky, and serves approximately 487 residential and 9 commercial customers in Montgomery County, Kentucky.

TEST PERIOD

The Commission has adopted the 12-month period ended December 31, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

Reid Village proposed several adjustments to revenues and expenses in its original application. Reid Village's proposed adjustments include the effect that the new customers will have upon the revenues and expenses of the district. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Operating Revenue

Operating revenue for the test period as reported by Reid Village has been adjusted due to the misclassification of tap-on fees and utility taxes.

In accordance with the Uniform System of Accounts for Class C Water Utilities, tap-on fees should be charged to Account No. 271--Contributions in Aid of Construction. In response to an information request¹ regarding a breakdown of \$1,521 reported as tap-on fees, Reid Village stated that tap-on fees collected during the test period actually amounted to \$700, while \$821 consisted of charges for disconnection and reconnection of meters. The \$821 should be charged to Account No. 471--Miscellaneous Service Revenues.

Reid Village included \$251 from a utility tax as revenue in its original application. In response to an information request,²

¹ Response to Commission's Information Request dated May 3, 1984, Item No. 11.

² Ibid., Item No. 4.

Reid Village stated that the source of the \$251 is a 3 percent tax levied on all utility bills by the Montgomery County School Board, effective October 1, 1983. Reid Village collected and remitted the full amount of \$251, receiving no commission. Since this utility tax, in the amount of \$251, should not be accounted for as either a revenue or an expense, test-year operating revenue has been adjusted to exclude the \$251.

The adjustment to test-year operating revenue amounts to a net reduction of \$951, including the adjustment to increase miscellaneous service revenue of \$821, the exclusion of \$1,521 in reported tap-on fees, and the exclusion of \$251 collected for the school board.

Purchased Water Expense

Reid Village proposed to increase the test-period purchased water expense by \$1,392 to reflect the 31 additional customers.³ Subsequently, Reid Village stated that the increase should have been \$1,476.⁴

Since all 31 of the additional customers are residential, the test-year annual average per residential customer⁵ was multiplied by 31 to arrive at the approximate number of additional gallons that would be consumed by the added customers. This

³ Exhibit "O" of the Application dated March 19, 1984.

⁴ Response to Commission's Information Request dated May 3, 1984, Item No. 22.

⁵ $31,538,360 \text{ gallons} \div 487 = 64,760 \text{ gallons.}$

amount of 2,007,560 gallons⁶ was then multiplied by the rate of 50 cents per 100 cubic feet⁷ to arrive at the Commission's adjustment to purchased water expense of \$1,342.⁸

Water Treatment Expense

Reid Village proposed to increase its expense for water samples to an adjusted level of \$312 based on the addition of new customers. No evidence was provided by Reid Village to support its contention that this cost will increase as a result of the increase in customers. Therefore, the proposed adjustment has been denied and the actual test year expense of \$295 has been included for rate-making purposes.

Supplies Expense

Reid Village reported test-year supplies expense of \$2,044. After examination of copies of several invoices from Mid-States Meter and Supply Company, Inc., the Commission has determined that several items were inappropriately expensed and should have been capitalized. Thus, an adjustment of \$964 has been made to test-year supplies expense. Reid Village's proposed adjustment to increase supplies expense by \$204 was not accepted because it was based on inflation⁹ and is not known and measurable.

⁶ 64,760 gallons X 31 = 2,007,560 gallons.

⁷ Per contract with Reid Village's supplier.

⁸ 2,007,560 gallons ÷ 748 gallons (100 cubic feet) = 2,683.9
\$.50
\$ 1,342

⁹ Response to Commission's Information Request dated May 3, 1984, Item No. 6.

Depreciation Expense

According to the 1983 Annual Report, gross utility plant in service at the end of the test period amounted to \$129,923. Because the test-year supplies expense was reduced by \$964, as explained above, the gross utility plant in service amount should be increased by \$964 which increases that total to \$130,887. Based upon the revised plant amount of \$130,887 and the test-year composite depreciation rate of 1.99888 percent,¹⁰ depreciation expense (before adjusting for depreciation on contributed property) would be \$2,616.¹¹

It is an established policy of the Commission to disallow, for rate-making purposes, depreciation associated with contributed property. Contributions in aid of construction totaled \$58,412 at the end of the test year, according to the 1983 Annual Report. However, in that report, tap-on fees were reported in the amount of \$189. According to a response to an information request,¹² the correct amount of tap-on fees for 1983 (the test year) is \$700. Thus, contributions in aid of construction should be increased by \$511 to a total of \$58,923. After that adjustment, depreciation on contributed property comes to \$1,178.¹³ Thus, the revised test-period allowable depreciation expense comes to \$1,438.¹⁴

¹⁰ Test-period depreciation expense $\$2,597 \div \$129,923 = 1.99888\%$.

¹¹ $\$130,887 \times 1.99888\% = \$2,616$.

¹² Response to Commission's Information Request dated May 3, 1984, Item No. 11.

¹³ $\$58,923 \times 1.99888\% = \$1,178$.

¹⁴ $\$2,616 - \$1,178 = \$1,438$.

Reid Village has proposed to adjust test-year depreciation expense to reflect depreciation on new construction at a rate of 2 percent. The adjustment of \$4,300 is 2 percent of \$215,000, the estimated cost of the new construction according to the application of March 19, 1984. However, at the hearing on July 18, 1984, Reid Village stated that the cost of new construction is now estimated to be \$271,000.¹⁵ Of that total, \$125,000 will be a loan from FmHA, while another \$91,000 will come from FmHA as a grant. Reid Village proposes to supply the remaining \$55,000. Of that \$55,000, \$10,850¹⁶ will come from tap-on fees, leaving a balance of \$41,150 which will come from current funds on hand. Two percent of \$571,000 is \$5,420, but this amount must be adjusted for contributed property for rate-making purposes. Of the \$271,000 total estimated cost, the contributed portion will be \$101,850.¹⁷ Thus, depreciation on contributed property amounts to \$2,037.¹⁸ Allowable depreciation expense on new construction is \$3,383.¹⁹ Total allowable depreciation expense for the test year amounts to \$4,821.²⁰ Thus, the Commission has determined that the proper adjustment to test-year depreciation expense is \$2,224.²¹

¹⁵ Transcript of Evidence, July 18, 1984, p. 12.

¹⁶ $31 \text{ (customers)} \times \$350 \text{ (authorized tap-on fee)} = \$10,850.$

¹⁷ $\$91,000 \text{ (Grant)} + \$10,850 \text{ (Tap-on Fees)} = \$101,850.$

¹⁸ $\$101,850 \times 2\% = \$2,037.$

¹⁹ $\$5,420 - \$2,037 = \$3,383.$

²⁰ $\$1,438 + \$3,383 = \$4,821.$

²¹ $\$4,821 - \$2,597 = \$2,224.$

Utility Tax

The Commission has determined that an adjustment to reduce test-year operating expense by \$251 is necessary to exclude the expense labeled "utility tax." As explained previously in the section of this Order titled "Operating Revenue," this item should not be accounted for as an expense. Since Reid Village is acting as a collection agency in this regard, this item should be carried on the balance sheet, rather than on the income statement.

Inflationary and Estimated Expense Adjustments

Reid Village has proposed adjustments to the following expense items: (1) maintenance; (2) office expense; (3) insurance; (4) miscellaneous general expense; and (5) professional fees (or outside services). Item Nos. 1-4 were based upon inflation,²² and Reid Village proposed to increase each of these by a flat rate of 10 percent. The adjustment to Item No. 5 was based upon an estimate.²³ It is the Commission's policy not to allow adjustments based upon inflation or estimates. Rather, adjustments are to be based upon items that are known and measurable.

Interest Income

Reid Village proposed to reduce test-year interest income due to the redemption of \$44,500 in certificates of deposit to

²² Response to Commission's Information Request dated May 3, 1984, Item No. 6.

²³ Exhibit "O" of the Application of March 19, 1984, Footnote No. 5.

help finance the new construction. The proposed adjustment amounts to \$3,963. This was based on an estimated interest rate of 8.905 percent.²⁴ Because Reid Village now expects to receive \$10,850 in tap-on fees from the 31 new customers, only \$44,150 in certificates of deposit will need to be redeemed.

The average level of investments during the test period amounts to \$66,550.²⁵ Interest income reported for the test year is \$5,795. Thus, the interest rate earned on the average level of investments for the test year is 8.708 percent.²⁶ Applying this interest rate to the amount of \$44,150 results in an adjustment to test-year interest income of \$3,845.²⁷ Therefore, the Commission has determined that test-year interest income should be reduced by that amount.

After consideration of the aforementioned adjustments, the Commission finds Reid Village's test period operations to be as follows:

²⁴ Response to Commission's Information Request dated June 22, 1984, Item No. 6.

²⁵

Cash Investment - Beginning of Test Year	\$ 63,700
Cash Investment - End of Test Year	69,400
Total	<u>\$133,100</u>
Average Investment for Test Year \div	<u>2</u>
	<u>\$ 66,550</u>

²⁶ $\$5,795 \div \$66,550 = 8.708\%$.

²⁷ $\$44,150 \times 8.708\% = \$3,845$.

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$65,168	\$ <951>	\$64,217
Operating Expense	55,796	2,851	58,647
Net Operating Income	<u>\$ 9,372</u>	<u>\$ <3,802></u>	<u>\$ 5,570</u>
Interest Income	5,795	<3,845>	1,950
Interest on Long-Term Debt	2,358	11,406	13,764
Net Income	<u><u>\$12,809</u></u>	<u><u>\$<19,053></u></u>	<u><u>\$<6,244></u></u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the adjusted test-period operating loss is clearly unjust and unreasonable. The Commission finds the debt-service coverage method to be a fair, just and reasonable method of determining revenue requirements in this case and adequate to allow Reid Village to pay its operating expenses, meet its debt-service requirements and maintain a reasonable surplus. The Commission finds Reid Village's revenue requirement to be \$77,789 based upon a 1.2X debt-service coverage which would require an increase in annual revenue of \$11,622 from sales of water.

FINDINGS AND ORDERS

The Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

2. The proposed improvements to the Reid Village water system include a new 100,000-gallon water storage tank, 31 residential service connections, about 3 miles of 6- and 4-inch water main and miscellaneous appurtenances.

3. Reid Village's motion for a certificate of public convenience and necessity filed July 25, 1984, for providing water service to an additional 17 customers cannot be considered at this time due to insufficient documentation.

4. Should Reid Village determine that it needs to perform additional construction not expressly certificated by this Order, it should file a new application with the Commission requesting the necessary approvals.

5. The low bids received for the proposed improvements totaled \$194,452 which will require about \$271,000 in project funding after allowances are made for fees, contingencies and other indirect costs.

6. Any deviations from the construction herein approved which could adversely affect service to any customer should be subject to the prior approval of this Commission.

7. The proposed borrowing of \$125,000 is for lawful objects within the corporate purposes of Reid Village, is necessary and appropriate for and consistent with the proper performance of services to the public by Reid Village, and will not impair its ability to perform these services.

8. The financing secured by Reid Village for this project will be needed to pay for the work herein approved. Reid Village's financing plan should, therefore, be approved.

9. Reid Village should file with the Commission duly verified documentation which shows the total costs of construction including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Said construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

10. Reid Village's contract with its Engineer should require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. The supervision and inspection should insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

11. Reid Village should require the Engineer to furnish a copy of the record plans and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

12. A 5/8-inch x 3/4-inch meter should be the standard customer service meter for all new customers and should be installed at all points of service unless the customer provides sufficient justification for the installation of a larger meter.

13. Reid Village should file with the Commission a copy of all contractual agreements for the provision of services or the

purchase of services which are subject to the approval of this Commission.

14. The rates in Appendix A are the fair, just and reasonable rates for Reid Village in that they will produce gross annual revenue from water sales of \$75,018. These revenues will be sufficient to meet Reid Village's operating expenses found reasonable for rate-making purposes, service its debt and provide a reasonable surplus.

15. The rates proposed by Reid Village would produce revenue in excess of that found reasonable herein and should be denied.

16. Reid Village has incorrectly reported as expenses on its test-period income statement amounts that should be capitalized as utility plant in service.

IT IS THEREFORE ORDERED that Reid Village be and it hereby is granted a certificate of public convenience and necessity to proceed with the waterworks improvements projects set forth in the plans and specifications of record herein.

IT IS FURTHER ORDERED that Reid Village shall obtain approval from the Commission prior to performing any additional construction.

IT IS FURTHER ORDERED that any deviations from the approved construction which could adversely affect service to any customer shall be subject to the prior approval of this Commission.

IT IS FURTHER ORDERED that Reid Village's plan for financing its construction work in the amount of \$271,000, including a

40-year loan of \$125,000 at 9 1/8 percent annual interest from the FmHA, be and it hereby is approved.

IT IS FURTHER ORDERED that Reid Village shall file with the Commission duly verified documentation which shows the total costs of construction herein certificated including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

IT IS FURTHER ORDERED that the contract between Reid Village and its Engineer shall require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. This supervision and inspection shall insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

IT IS FURTHER ORDERED that Reid Village shall require the Engineer to furnish to the Commission a copy of the record plans and a signed statement that the construction has been satisfactorily completed and done in accordance with the contract plans and specifications within 60 days of the date of substantial completion of the proposed construction. Said construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

IT IS FURTHER ORDERED that a 5/8-inch x 3/4-inch meter shall be the standard customer service meter for all new customers and shall be installed at all points of service unless the customer

provides sufficient justification for the installation of a larger meter.

IT IS FURTHER ORDERED that Reid Village shall file with the Commission a copy of all contractual agreements for the provision of services or for the purchase of services which are subject to the approval of this Commission.

IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Reid Village on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Reid Village be and they hereby are denied.

IT IS FURTHER ORDERED that Reid Village shall capitalize all items of water utility plant in the appropriate plant in service accounts in accordance with the Uniform System of Accounts for Class C Water Utilities.

IT IS FURTHER ORDERED that within 30 days from the date of this Order, Reid Village shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 6th day of August, 1984.

PUBLIC SERVICE COMMISSION

Richard D. Herman Jr.
Chairman

Paul H. [Signature]
Vice Chairman

[Signature]
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 9012 DATED 8/6/84

The following rates are prescribed for customers served by Reid Village Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

GALLONAGE BLOCK

RATES

First 2,000 gallons

\$7.80 Minimum

Over 2,000 gallons

1.15 per 1,000 gallons